SKAGIT PROJECT: AUDIT RECOMMENDATIONS IMPLEMENTATION FOLLOW-UP REVIEW

FEBRUARY 9, 2004

City of Seattle
Office of City Auditor

Susan Cohen, City Auditor

February 9, 2004

The Honorable Greg Nickels
Councilmembers
City of Seattle
Seattle, Washington

Dear Mayor Nickels and City Councilmembers:

Attached is our *Skagit Project Implementation of Audit Recommendations Follow-Up Review.*
The primary objectives of the review were to determine whether Skagit Project management
implemented recommendations that emerged from our 1999 and 2001 cookhouse, general store,
and commute trip reduction program reviews. We also considered whether opportunities exist to
improve the financial and operational situation of the cookhouse, general store, and commute trip
reduction program.

We concluded that Skagit Project management partially or fully implemented 12 of the 16
recommendations from our 1999 and 2001 audits, and considerably improved financial
operations of the cookhouse and general store. However, the cookhouse, general store, and
commute trip reduction program continued to operate at a deficit.

Based upon our observations and analysis of operations, we determined that Skagit Project
management could implement improvements to achieve greater financial self-sufficiency and
reduce losses at the cookhouse, general store, and commute trip reduction program. Specifically,
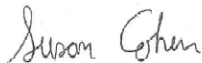Skagit Project management could improve operations by:

- Developing a new food service classification with reasonable wages for cookhouse
  personnel;
- Strengthening general store cash-handling and inventory controls to minimize the risk of
  loss;
- Increasing cost effectiveness of the commute trip reduction program by eliminating the
  Seattle City Light-owned van service, renegotiating the Skagit Transit vanpool contract, or
  eliminating the vanpool and extending the $15 commute trip subsidy to employees that
  carpool; and
- Enhancing management-level information and reporting systems.

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Seattle City Light and Skagit Project management informally responded to the draft report, indicating that they have initiated several improvements to address concerns outlined in earlier reviews as well as the attached report. Specifically, Skagit Project management began upgrading the general store's operating system to support recently purchased hand-held bar code scanners. The bar code scanning hardware better enables general store staff to quickly and accurately enter inventory transactions (such as ordering or receiving inventory), and to complete biannual merchandise counts.

Seattle City Light Cost Accounting Section also agreed to supply quarterly operating statements to cookhouse and general store management. Additionally, the cookhouse billing and reservation system is being updated to more user-friendly software applications that can provide meaningful management level reports for cookhouse operations. Skagit Project management expects to fully implement these improvements by April 2004.

Sincerely,

Susan Cohen
City Auditor

SC:SB:SBB:tlb

SKAGIT PROJECT IMPLEMENTATION OF AUDIT RECOMMENDATIONS FOLLOW-UP REVIEW

FEBRUARY 9, 2004

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CHAPTER 1: INTRODUCTION AND SUMMARY

Seattle City Light operates three hydroelectric dams at the Skagit Project located in the remote Ross Lake National Recreation Area, approximately 125 miles northeast of Seattle. In order to accommodate employees assigned to the remote construction site, Seattle City Light established the two company towns of Newhalem and Diablo, where the Skagit Project cookhouse, general store, housing, and tourist facilities are located. Seattle City Light also offers commuter services to Skagit Project-based employees, consistent with the City's commute trip reduction policy.[1]

After a 1998 hydroelectric generation benchmarking study ranked the Skagit Project cost per megawatt hour as the ninth highest among 31 medium-sized facilities, Seattle City Light asked the Office of City Auditor to review the Skagit Project's indirect (non-power generation) operating costs. In response to this request, we conducted three audits on the Skagit Project cookhouse, general store, and commute trip reduction program between 1999 and 2001. We initiated this follow-up review of the cookhouse, general store, and commute trip reduction program to assess the utility's progress in implementing our audit recommendations for improving operational efficiency and reducing expenses at the Skagit Project. (Appendix 1 contains a listing of our 1999 and 2001 audit recommendations and a summary of Skagit Project's progress in implementing those recommendations.)

RESULTS IN BRIEF

Based on our 2003 follow-up review of the Skagit Project cookhouse, general store, and commute trip reduction services, we determined that Skagit Project management fully or partially implemented 12 of the 16 recommendations contained in our 1999 and 2001 audits. Noteworthy improvements and additional operating efficiencies discussed in this report include:

- Reducing the overall operating expenses for the cookhouse, general store, and commute trip reduction program by $509,574 (48 percent), from $1.1 million in 1998 to $546,460 at year-end 2002. Although the total operating deficit also declined by $366,093 (67 percent) from 1998 to 2002, operating expenses continued to outpace revenues due to a 28 percent decline in cookhouse and general store proceeds.

- Decreasing the cookhouse annual operating expenses and operating deficit by 71 percent and 75 percent, respectively, from 1998 to 2002 by reducing labor and food costs. Despite the improvements, the average meal cost at the Skagit Project continued to exceed that of local area restaurants, as well as the Washington State reimbursement rate for employees traveling within Skagit County. To further reduce operating costs, Skagit Project management could create a food service worker classification and develop routine management-level reports for ongoing monitoring of financial activity.

- Reducing general store staffing levels and winter hours of operation, resulting in a 30 percent reduction in operating expenses and a 59 percent reduction in the operating deficit from 1998 to 2002. Skagit Project management also strengthened its internal controls at the general

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[1]Ordinance 116680 establishes the City's commute trip reduction program to encourage employees' use of public transportation.

store by increasing store security; segregating merchandising and accounting duties; and implementing an improved retail sales information system. More effective cash-handling procedures and inventory practices as well as management-level financial reports are needed, however, to adequately protect store assets and better control store operations and costs.

- Discontinuing the use of a City-owned van to supplement Skagit Transit's commuter services from 1998 to 2002. When Skagit Project management ultimately resumed use of the van in 2003, the overall operating expenses increased by 14 percent. Ridership also declined during this period, resulting in a 19 percent reduction in revenues, and the average total subsidy of Skagit Project-based commuters rose from $42 in 1998 to $72 (71 percent) in 2002.

We also determined that Seattle City Light and Skagit Project management did not fully address the numerous cookhouse and general store recommendations developed in its Employee Involvement Committee's *Preliminary Report: An Investigation of Whether the Skagit General Store and the Diablo Cookhouse Can Be "Break-Even" Operations*, or in its consultant's report, titled *Upper Skagit Tours/Visitor Attractions Operations and Marketing Recommendations*, due to national security and local union concerns. Opportunities now exist to reconsider the report recommendations to improve Skagit Project support operations and costs. (Appendices 2 and 3 contain the recommendations of the Employee Involvement Committee and Chandler, Brooks, and Donahue reports).

SCOPE AND METHODOLOGY

We initiated a follow-up review of the cookhouse, general store, and commute trip reduction program to evaluate the current financial and program status of these Skagit Project support operations, as well as Skagit Project management's progress in implementing the 1999 and 2001 audit recommendations. During the follow-up review, the Office of City Auditor:

- Reviewed the operating policies and procedures for the cookhouse and general store; the WinSell User Guide for the general store; and other studies, including the Seattle City Light Employee Involvement Committee *Preliminary Report: An Investigation of Whether the Skagit General Store and the Diablo Cookhouse Can Be "Break-Even" Operations* and the Chandler, Brooks, and Donahue *Upper Skagit Tours/Visitor Attractions Operations and Marketing Recommendations*;

- Developed summary matrices to track the recommendations from the initial 1999 and 2001 audit reports on the cookhouse, general store, and commuter services, and pertinent recommendations from the Employee Involvement Committee and consultant studies;

- Interviewed Skagit Project staff, including the Project Manager, Food Service Supervisor, Storekeeper, and other cookhouse and general store personnel;

- Conducted on-site visits at the Skagit Project facilities, and an unscheduled cash count at the general store;

- Researched food service industry, retail industry, and public transit regional cost indices to determine the reasonableness of current Skagit Project costs and reimbursement rates, and to identify best operational and internal control practices; and

- Analyzed Summit financial information;[2] WinSell inventory data; reservation and billing data; general store sales reports; and other documents pertaining to the cookhouse, general store, and commuter services.

We conducted the Skagit Project follow-up review in accordance with government and internal auditing standards. We initiated our follow-up review in July 2003, and completed our fieldwork and data collection activities in August 2003.

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[2]Summit is the City of Seattle's financial and accounting system.

CHAPTER 2: SKAGIT PROJECT OPERATIONS

In July 2003, we reviewed Skagit Project management's progress in implementing the recommendations contained in the 1999 and 2001 financial and performance reviews of the Skagit Project cookhouse, general store, and the commute trip reduction program. Our conclusion is that Skagit Project management made progress in implementing 12 of 16 financial, operational, and internal control improvements, such as reducing the cookhouse and general store annual expenditures and operating deficit. However, Skagit Project management needs to:

- Develop a reasonable food service worker classification and salary rate for cookhouse personnel;
- Further strengthen internal controls at the general store to minimize risk of loss;
- Improve the cost-effectiveness of the commute trip reduction program and reduce its monthly employee subsidy; and
- Expand its management-level information and reporting systems to facilitate oversight of the cookhouse and general store operations.

To further improve the support functions and costs, Skagit Project management may want to address pertinent recommendations from the Seattle City Light Employee Involvement Committee's *Preliminary Report: An Investigation of Whether the Skagit General Store and the Diablo Cookhouse Can Be "Break-Even" Operations*, and its consultant's report, titled *Upper Skagit Tours/Visitor Attractions Operations and Marketing Recommendations*. Alternatively, Seattle City Light may determine that the lower deficits incurred in the operation of the cookhouse, general store, and commute trip reduction program are acceptable, given the importance of these services to employees and the higher costs associated with conducting business in a remote location. If so, Seattle City Light and Skagit Project management will need to establish new performance and financial goals for its indirect support functions.

Skagit Project Cookhouse, General Store, and Commute Trip Program Operations and Expenses

Skagit Project management currently operates a cookhouse, located in Diablo, which consists of a commercial kitchen, full-service cafeteria and dining room. The cookhouse serves three full-course meals daily, primarily for nonresident Seattle City Light personnel, on a reservation-only basis. During the summer months, the cookhouse also prepares box lunches for tourists.

Skagit Project management operates a general store (commissary), located in Newhalem, which sells food, refreshments, and other goods to its employees and other local residents located in the remote Skagit area. Between April and November, the general store also stocks and sells postcards, gifts, clothing, and other items to sell to tourists.

Skagit Project management, in cooperation with Skagit Transit, also provides vanpool services to Skagit Project personnel. Skagit County Transit operates three vans, and Skagit Project management operates one van providing seven-day-a-week transportation coverage for Skagit Project commuters.

Improving the Skagit Project's operating efficiency and costs was a primary objective of the 1999 and 2001 audits of the cookhouse, general store, and commute trip reduction program. Exhibit 1 below displays the annual expenditures, revenues, and net operating deficit for all three functions in 1998 and 2002. These data are referenced throughout this report.

Exhibit 1 Skagit Project 1998 and 2002 Financial Summary for the Cookhouse, General Store, and Commute Trip Reduction Program				
Expenditures	**1998**	**2002**	**1998 to 2002** **Decrease (Increase)**	**Percent** **Change**
Cookhouse	$502,624	$144,361	$358,263	–71%
General Store	521,616	365,750	155,866	–30%
Commute Trip Program	31,794	36,349	(4,555)	14%
Total Expenditures	*$1,056,034*	*$546,460*	*$509,574*	*–48%*
Revenues				
Cookhouse	$139,612	$ 55,063	$ 84,549	–61%
General Store	352,517	297,023	55,494	–16%
Commute Trip Program	17,916	14,478	3,438	–19%
Total Revenues	*$510,045*	*$366,564*	*$143,481*	*–28%*
Operating Deficit				
Cookhouse	$363,012	$89,298	$273,714	–75%
General Store	169,099	68,727	100,372	–59%
Commute Trip Program	13,878	21,871	(7,993)	58%
Total Operating Deficit	*$545,989*	*$179,896*	*$366,093*	*–67%*
Source: Seattle City Light Cost Accounting, August 2003.				

As shown above in Exhibit 1, the overall deficit for the Skagit Project cookhouse, general store, and commuter services declined by 67 percent from $545,989 in 1998 to $366,093 in 2002. New cost containment initiatives, such as reduced hours of operation and staffing, contributed to the substantially lower operating expenditures at the cookhouse and general store.

Despite management's efforts, however, the operating deficit persisted due to corresponding decreases in total cookhouse, general store, and commute trip reduction program revenues, and escalating vanpool expenses. Project-wide staffing reductions and the closure of tourist facilities to the general public following the September 11 terrorist attacks in 2001, contributed to the declining revenue base for these Skagit Project support functions.

AUDIT FINDINGS AND RECOMMENDATIONS

The following findings discuss Skagit Project management's response to the recommendations presented in our 1999 and 2001 audits. The first finding addresses the Skagit cookhouse operating expenses and deficit. The second, third, and fourth findings focus on the Skagit general store's operations and internal controls. The fifth finding reports on the cost-effectiveness of the commute trip reduction program. Recommendations from our 1999 and 2001 audits are summarized in italics for ease of reference.

Finding 1: Skagit Project Management Partially Implemented the 2001 Cookhouse Audit Recommendations and Substantially Reduced Its Annual Operating Expenses and Deficit from 1998 to 2002. Opportunities Exist to Further Improve the Cookhouse Operations.

The Office of City Auditor's financial and performance review of the cookhouse operations concluded that the average hourly labor cost was approximately 73 percent higher than the food industry average. Food product costs were more than five times greater than the food industry average. Factors that led to higher-than-industry costs, included: 1) the absence of a food service worker classification; 2) an inadequate reservation and billing system and inability to access the Summit system; 3) excess food supply and production expenses; 4) prices that did not fully cover tourist meal costs; and 5) absorption of food product and production expenses related to the general store and tour center operations. Our 2001 and follow-up audit observations and recommendations are presented below.

Cookhouse 2001 Audit Recommendation #1: Skagit Project management should continue to reduce the cookhouse operating deficit by establishing a new Food Service Aide classification with a compensation rate comparable to prevailing local restaurant wages. The Food Service Supervisor should continue to seek and implement cost reduction initiatives to achieve a more efficient and economical cookhouse operations.

Skagit Project management decreased the cookhouse annual operating expenses and operating deficit by $358,263 (71 percent) and $273,714 (75 percent), respectively, from 1998 to 2002 by reducing labor and food costs. Exhibit 2 below displays the substantial reduction in the cookhouse's operating expenses and operating deficit from 1998 to 2002.

Exhibit 2: Cookhouse Annual Operating Expenses and Operating Deficit, 1998 to 2002
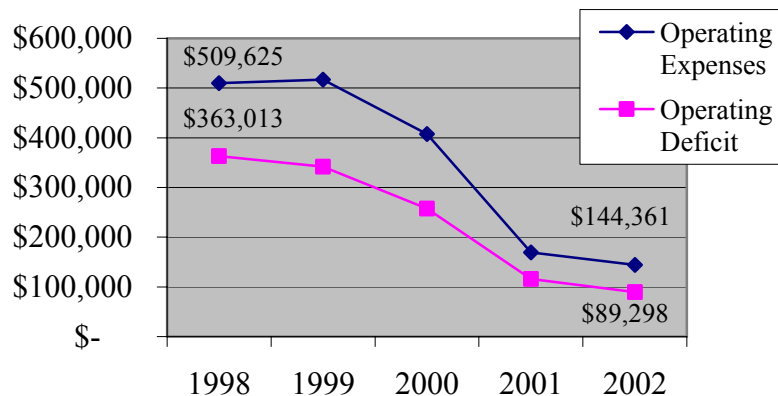
Specific cost reduction initiatives implemented by the Food Service Supervisor included restructuring kitchen schedules and minimizing staff hours; minimizing food waste; eliminating free meal service to private contractors, tour guides, and outside staff; and discontinuing special meal services outside standard business hours unless costs could be fully recovered. Management did not attempt to institute a new food service worker classification, because the staffing requirements and work hours substantially decreased in proportion to the reduced number of meals served to visiting City Light employees and tourists in 2001 and 2002.

However, Skagit Project management resumed tourist meal services with the introduction of the new Diablo Adventure tour program in June 2003. Camp Service Aides earn up to $18.60 an hour, including benefits and other overhead costs, even when assigned to cookhouse duties during public tours. These salary rates far exceed the local area average hourly wage of $8.40 for food service personnel.[3] Seattle City Light management could establish more competitive wages by creating a Food Service Aide classification, as recommended in our 2001 audit. A new food service worker classification and wage rate would require negotiations between Seattle City Light management and the Union Local #77 representing Skagit Project employees at the end of the current contract period. The earliest potential effective date for implementing a revised salary schedule would be January 2005.

Cookhouse 2001 Audit Recommendation #2: *Seattle City Light and Skagit Project management should ensure that food production and supply costs incurred for general store and tour meals are charged to appropriate cost centers. A higher tour meal price should be negotiated with the tour center and a profit-sharing agreement based on actual revenue sales should be established with the general store.*

Skagit Project management worked with the Seattle City Light Cost Accounting Section to improve the accuracy of food production and supply accounting. The Food Service Supervisor now uses distinct dash numbers to charge labor costs and food supplies to the appropriate tour and general store cost centers.

When the Diablo Adventure tour program was established in June 2003, the Food Service Supervisor replaced the all-you-can-eat, $7 tourist dinner with a $10 tourist lunch box. The $10 per-box lunch charge covers the full labor and supply cost. The $10 charge is also consistent with local area restaurant meal prices and generates a $5 per-box profit.

Cookhouse 2001 Audit Recommendation #3: *Seattle City Light and Skagit Project management should establish a financial goal or target for reducing the average cost per meal to a level consistent with the federal per diem rate,[4] as well as staff expenses for local area restaurant meals. If the cookhouse's average daily meal cost cannot be sufficiently reduced, management should consider alternative food service arrangements.*

Skagit Project management did not establish a formal meal cost target, but reduced its daily average meal costs from $33.77 in 1998 to $28.08 in 2002. This represents a total unit cost reduction of $5.69 (12 percent) per meal. Exhibit 3 below displays the daily average meal costs from 1998 to 2002.[5]

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[3]A 2003 telephone survey of five restaurants in Skagit County established an average local area restaurant wage of $8.40 an hour for food service workers.
[4]Because the Seattle-area federal per diem rate does not consider lower market indices in other areas of the state, we used the Washington State Office of Financial Management's reimbursement rate for Skagit County in our analysis.
[5]The 1998 and 1999 average per-meal costs were somewhat inflated, because cookhouse reporting formats included some general store and tour center expenditures.

**Exhibit 3: Cookhouse Average Meal Cost
1998 to 2002**
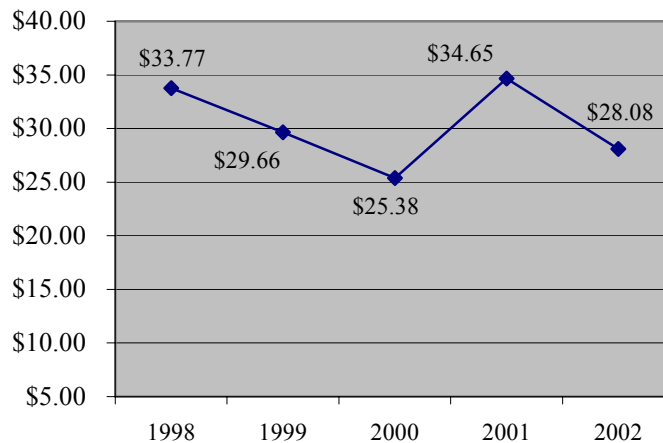
We compared the cookhouse average meal costs, shown in Exhibit 3 above, to the Washington State Office of Financial Management's average meal reimbursement rate of $14.33 for Skagit County. The 2002 average meal cost of $28.08 far exceeded the Washington State meal reimbursement rate despite substantial average meal cost reductions, because the cookhouse could not achieve economies of scale given the reduced demand for meal services. In fact, the average meal cost increased from $25.38 in 2000 to $34.65 in 2001 with the elimination of tour meal services. In 2002, Skagit Project management limited cookhouse staffing to less than 2 full-time equivalent positions to achieve a more competitive meal cost. However, the average meal cost of $28.08 was nearly twice the Washington State Office of Financial Management average meal reimbursement rate.

Due to the high average cookhouse meal cost, however, Seattle City Light employees visiting the Skagit Project can obtain more economical meals at local area restaurants. Seattle City Light management may ultimately determine that operating the cookhouse at a loss is acceptable given the Skagit Project's distance from retail food service establishments. If so, Seattle City Light could consider developing a policy that acknowledges the necessity of subsidizing cookhouse operations for the benefit of its employees.

Cookhouse 2001 Audit Recommendation #4: *The Seattle City Light Finance Division should improve the cookhouse's automated reservation and billing system to generate accurate and useful information for accounting and reporting purposes. Cookhouse personnel should receive adequate training to use the automated reservation and billing system as well as the City's Summit system.*

Cookhouse 2001 Audit Recommendation #5: *The Seattle City Light Cost Accounting Section and Skagit Project management should develop reporting formats for routine monitoring of the cookhouse financial data to verify that expenses are charged to the correct accounts and to control excess expenditures and meal costs.*

Since 2001, Seattle City Light Information Technology has worked with the Food Service Supervisor to improve the automated billing and reservation system, as well as to ensure that the software applications produce accurate meal counts and billing statements. The Food Service Supervisor and an Account Technician II received training to operate the new billing system.

Because the reservation system does not interface with the Summit system, however, the Food Service Supervisor was still unable to easily process reservations and maintains a manual system for daily meal counts. In addition, Cost Accounting Section personnel have not yet developed additional reporting formats to generate management-level cookhouse summary data, and the Food Service Supervisor has not yet received Summit training. Without access to detailed financial information, the Food Service Supervisor in unable to make informed decisions to develop and implement effective cost-saving and revenue-generating initiatives at the cookhouse.

In summary, Skagit Project management partially implemented the 2001 audit cookhouse recommendations, which have resulted in substantial savings to Seattle City Light. Nevertheless, the cookhouse is not yet self-sustaining. Skagit Project management may want to implement additional operating improvements identified in the 2001 audit, or develop a policy that acknowledges the necessity of subsidizing cookhouse operations for the benefit of its Skagit-based employees.

FOLLOW-UP RECOMMENDATIONS

1. Skagit Project management should reconsider establishing a new Food Service Aide classification for employees who will be assigned to cookhouse duties now that tour meal services have resumed.

2. Seattle City Light should consider food service alternatives, such as reimbursing employees visiting the Skagit Project for meals consumed at local restaurants, or consider formulating a written policy that acknowledges the necessity of subsidizing cookhouse operations.

3. Skagit Project management should work with the Seattle City Light Cost Accounting Section to develop a fully integrated, automated billing and financial system that provides timely information on cookhouse meal revenues, expenditures, counts, and per-meal costs.

4. Skagit Project management should ensure that the Food Service Supervisor receives training to utilize the Summit system and to generate effective financial reports to inform operational decisions.

Finding 2: Skagit Project Management Partially Implemented the 1999 General Store Recommendations, Which Reduced Annual Operating Expenses and Improved Numerous Internal Control Weaknesses from 1998 to 2002.

In 1999, the Office of City Auditor conducted a financial review to determine whether the general store internal controls were adequate and whether the store could be operated as a self-sustaining retail business. We identified numerous deficiencies in the general store's internal controls and financial management practices, including:

- Ineffective internal control systems for cash and inventory handling;
- Inadequate use of information systems to support retail operations;
- Excess staffing and hours of operation based on the demand for goods and services;
- Employee salary and benefit expenses that were nearly double the industry average; and
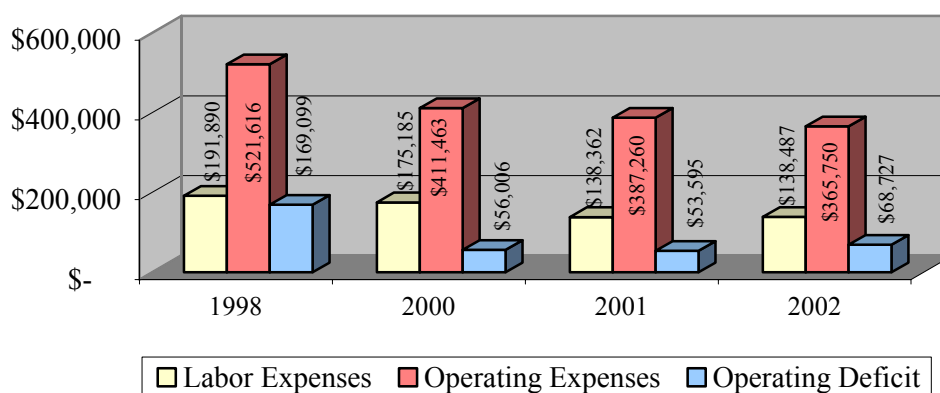- Absence of effective oversight of daily general store operations.

Our 1999 audit recommendations included several options to improve general store operations. The recommended options are consolidated and presented below, along with our current observations and recommendations.

General Store 1999 Audit Recommendation Option #1: *Seattle City Light should continue the status quo general store operations with a commitment to strong internal control systems and management reporting, while reducing hours of operation and budgeting appropriately.*

General Store 1999 Audit Recommendation Option #2: *Alternatively, Seattle City Light should study the potential savings of contracting with an experienced small vendor or national service provider to operate the general store for Skagit Project employees and the general public.*

Since 1999, Seattle City Light management implemented internal control improvements and retained a consultant in its efforts to achieve more cost-effective general store operations. General store hours were adjusted and reduced to accommodate the seasonal nature of customer demand, which resulted in a 28 percent reduction in staffing costs. Between 1998 and 2002, the general store operating expenses decreased from $521,616 to $365,750 (30 percent), and the operating deficits decreased from $169,099 to $68,727 (59 percent). This is noteworthy because general store revenues also declined by 16 percent during the same time period, due to the closure of the Skagit tour center for security reasons following the September 11 terrorist attacks. The general store expenditure and operating deficit reductions are displayed below in Exhibit 4.

Exhibit 4: General Store Labor and Total Operating Expenses, and Operating Deficit, 1998 to 2002

Bar chart showing Labor Expenses, Operating Expenses, and Operating Deficit for 1998, 2000, 2001, and 2002.

- 1998: Labor Expenses $191,890; Operating Expenses $521,616; Operating Deficit $169,099
- 2000: Labor Expenses $175,185; Operating Expenses $411,463; Operating Deficit $56,006
- 2001: Labor Expenses $138,362; Operating Expenses $387,260; Operating Deficit $53,595
- 2002: Labor Expenses $138,487; Operating Expenses $365,750; Operating Deficit $68,727

Legend: Labor Expenses · Operating Expenses · Operating Deficit

Skagit Project management was able to reduce the general store expenses and operating deficit, as shown above in Exhibit 4, by strengthening management and internal controls. Skagit Project management installed WinSell, a retail management information system, which led to improved operational practices and reporting on the general store's activities. Skagit Project management also minimized access to the general store safe; restricted and segregated cash-handling and accounting responsibilities; and instituted transaction logs for the store cashiers. The recently hired Storekeeper began generating daily statements of sales activities, spoil and loss reports, and a record of the daily safe count.

Other noteworthy internal control improvements included enhancing the physical security of the general store by routinely locking doors to the back office and the safe room; modifying the store layout; installing video cameras to better monitor customer activity; increasing cashier and cash register security by consistently locking unattended registers; and depositing excess cash into the safe at midday when cash register funds exceeded $300. Clerks also discontinued the practice of sharing cash drawers and routinely reconciled cash drawers with sales, which increased the accountability of cashier personnel, the accuracy of cash register drawer counts, and the promptness in resolving cash-handling issues.

Skagit Project management revised the general store policies and procedures to improve daily inventory controls, after our 1999 financial review identified a $100,000 discrepancy between the inventory records and a physical inventory. Only the Storekeeper can order and receive inventory, add or delete inventory counts, or otherwise change inventory information in the computer. Skagit Project management no longer permits non-store employees to enter the stockroom, and reduced the number of expensive items in the store inventory to minimize the risk and financial impact of theft. (Skagit Project management was unable to determine the effectiveness of the revised inventory practices, because a physical inventory count had not been conducted between October 1999 and July 2003. Please see Finding 4 below for a discussion of the inventory count recently initiated by Skagit Project management.)

Finally, Seattle City Light retained the consulting firm of Chandler, Brooks, and Donahue to explore alternatives for contracting out the cookhouse, general store, and other Skagit Project support services. The consultant completed a report that offered a series of recommendations for

improving the financial operations of the Skagit Project support facilities. Seattle City Light management chose not to implement the recommendations due to union resistance and higher-priority security concerns following the September 11 terrorist attacks.

Skagit Project management continues to be challenged by the general store's internal control weaknesses, despite the numerous improvements described above. Based on our observations of the store operations on July 30, 2003, cash-handling, inventory control, and management-level reporting improvements are still required to safeguard City inventory and revenues. Additional internal control and inventory improvements are discussed in Findings 3 and 4 below.

FOLLOW-UP RECOMMENDATIONS

Please see recommendations at the conclusion of Findings 3 and 4 pertaining to improved cash-handling and inventory practices at the general store.

Finding 3: Skagit General Store's Current Cash-Handling Policies and Procedures Could Be Further Improved to Minimize Risk of Loss or Theft.

During our follow-up study, audit staff reviewed the cash-handling policies for the general store, observed cash-handling operations, and conducted an unscheduled cash count. We identified weaknesses in the general store policies and internal controls, including inappropriate employee check-cashing practices; inadequate documentation of "paid-out" (petty cash) fund transactions; delayed drop of till proceeds into the general store safe; infrequent bank deposits; and inconsistent customer receipting practices.

- **Inappropriate Employee Check-Cashing Practices**—The *General Store Cash-Handling Procedures*, revised July 2003, do not contain provisions for cashing personal checks for Seattle City Light employees assigned to the Skagit Project, including general store employees. During the safe cash count, we found that the Storekeeper wrote and cashed a personal check in the amount of $25. The check, dated July 30, was cashed on the morning of our cash count, even though the safe count would typically include only cash (prior day's checks would have been deposited). Personal checks in the till counts cashed by other Skagit Project employees were also dated one to three days before our cash count.

  City policy does not generally permit employees to cash their own checks at City cash-handling sites. Skagit Project management recently installed an automatic teller machine (ATM) at the general store, which provides employees with an alternative for obtaining cash and generates revenue for the general store through the collection of transaction fees. Allowing general store employees to cash their own checks increases the Skagit Project exposure to risk of fraud, and depletion of cash reserves and change for sale transactions. This check-cashing practice also results in lost revenue for the general store's share of ATM transaction fees.

- **Inadequate Controls and Documentation for an Informal "Paid-Out" Fund**—According to the current Storekeeper, an informal "paid-out" fund was established at the general store,

but no internal controls were established to document allowable uses of the fund. The previous Storekeeper used the fund to pay "drop-in" vendors for purchases, but withdrew cash from the fund without adequate documentation. Currently, the safe contained $269 less than the $2,500 authorized, because the new Storekeeper does not have the receipts or other documentation required for reimbursement of the $269 vendor payment. Since the 1999 audit, however, the practice of paying drop-in vendors with cash was discontinued.

The Washington State Budgeting, Accounting, and Reporting System requires cities, counties, and other local governments to document petty cash withdrawals and restore petty cash funds to their original amount on at least a monthly basis. The absence of controls and documentation for paid-out or petty cash transactions resulted in a cash shortage in the safe and reduced the amount of change available for retail sales transactions.

- **Delayed Drop of Employee Checks in Safe**—During the till and safe counts, we found that cashiers did not consistently deposit employee checks into bank deposit bags during the till close-out process. Three of the five employee checks held in the till bags were dated prior to July 30, 2003, the day of our cash count.

  The City of Seattle Department of Finance cash-handling guidelines require that checks be dated for the day of purchase and deposited on the day of receipt. The current check-handling practices at the general store are inconsistent with City policy, as well as current general store policies directing employees to drop all funds into bank deposit bags at the conclusion of each shift. Delayed deposit of general store funds increases the risk of fraud and lost revenue.

- **Infrequent Bank Deposits**—Skagit Project administrative personnel only deposit cash and checks into Seattle City Light's State Bank of Concrete account once a week. Travel time impedes more frequent deposits of store proceeds, due to the 31-mile distance between the general store located in Newhalem and the State Bank of Concrete. As a result, the safe regularly contains large amounts of cash and checks generated at the general store in addition to a substantial amount of cash from other Skagit revenue-generating operations.

  Seattle Municipal Code 5.14.030 stipulates that cash-handling sites deposit proceeds into the bank within 24 hours of their receipt. Extended intervals between bank deposits increase the risk of loss due to fraud or theft as large amounts of cash accumulate in the safe, and diminish management's ability to recover missing or stolen funds as time lapses.

- **Inconsistent Customer Receipting Practices**—Skagit Project management has neither established a policy requiring store personnel to routinely provide receipts, nor posted a sign reminding customers to request a receipt for sales transactions. Cashiers do not routinely provide receipts to customers following retail transactions.

  The Washington State Auditor identified cash receipting as an important government cash-handling function in its 2003 *Washington State Budgeting, Accounting, and Reporting Systems* guidelines for cities, counties, and other local governments. Receipting is particularly important for cash transactions, because it provides further assurance that inventory records are accurate and risk of loss is minimized.

FOLLOW-UP RECOMMENDATIONS

1. Skagit Project management should expand its current cash-handling procedures to include a check-handling provision for both Skagit Project employees and store personnel. Management should prohibit store employees from processing their own checks or sales transactions, and encourage all Skagit Project employees to use the newly installed ATM to obtain cash, or use a debit card to receive "cash back" with purchases.

2. Skagit Project management should expand the current general store cash-handling procedures to include a provision directing employees to consistently drop checks into bank deposit bags at the end of each shift. Management should also minimize risk of loss by requiring more frequent bank deposits during the peak tourist season when higher volumes of revenue are generated.

3. Skagit Project management should develop a policy for the direct payment of vendors, appropriate documentation for all purchases, and prompt reimbursement of the paid-out safe funds with the proper receipts. Whenever possible, wholesale vendors should submit formal invoices to the City for reimbursement, and another Skagit employee who was not involved in the original transaction should process the paperwork for reimbursement of the paid-out funds. The Storekeeper should also develop a memorandum to the file detailing the history of the $269 paid-out funds and request immediate reimbursement to fully replenish the safe funds to the authorized amount.

4. Skagit Project management should establish a policy directing the Storekeeper and cashiers to provide customer receipts, and post signs near registers reminding customers to request receipts after each purchase.

Finding 4: Skagit Project Management Has Not Routinely Conducted Inventories of the General Store Merchandise Since 1999, or Established Formal Policies and Procedures for Carrying Out an Effective Inventory Count.

At the request of the Office of City Auditor, general store management conducted a physical count of its inventory in July 2003, which was the first full merchandise count completed since 1999. Adjustments to the inventory and accounting records were required for a total of 4,936 (55 percent) of the 9,045 categories of merchandise stocked. The adjustments were required to resolve differences between the number of items identified in the physical count and the number of items recorded in WinSell. Of the 4,936 items adjusted in WinSell, 1,612 items required positive dollar adjustments and 3,324 items required negative dollar adjustments.

We were unable to determine the underlying cause of many large adjustments due to inconsistent inventory controls and the lengthy, four-year period since the previous general store physical count. The Storekeeper acknowledged that many adjustments were required because lost or discarded items were not recorded in WinSell in a timely manner. Lack of routine documentation of discarded or lost inventory items decreases the general store's ability to manage its merchandise, and creates opportunities for theft.

The physical inventory count also demonstrated the need for Skagit Project management to periodically assess the general store inventory to eliminate overstocked or obsolete retail items. For example, the general store inventory included 16,780 postcards, many of which were several years old and unlikely to sell.

Skagit Project management did not apply standard retail practices when conducting inventory counts. Standard retail inventory practices would produce a more reliable result. Common retail procedures to prepare for and conduct inventory counts, as well as to follow up on results, include:

- Creating and adhering to agreed upon policies and procedures for conducting an inventory, and completing inventory counts on a regular basis;

- Identifying and resolving potential problem areas prior to conducting the physical inventory counts, and preparing staff to methodically conduct the counts;

- Establishing a time frame for determining when to suspend the receipt and sale of inventory items to prevent inaccurate counts, and conducting the actual inventory count within the determined time frame; and

- Following up on inventory results by making the proper and timely adjustments to inventory records, and conducting additional counts, if necessary, to achieve an acceptable result.

Skagit Project management could also request further training on retail inventory practices and consult with knowledgeable City personnel, such as the Office of City Auditor or the Department of Finance staff, to confirm the reasonableness of planned inventory procedures to improve the overall accuracy of subsequent inventories.

FOLLOW-UP RECOMMENDATIONS

1. Skagit Project management should develop policies and procedures for inventory counts based on the common retail practices described above. Skagit Project management should also consider consulting with the Office of City Auditor or the Department of Finance for guidance in developing the new inventory protocol.

2. Skagit Project management should set an acceptable range of error for inventory counts, and establish a target for reducing the level of cumulative adjustments to the WinSell database in subsequent inventories. The policies and procedures for writing off discarded or lost merchandise should include a provision requiring at least two people to document and consistently record inventory losses.

3. Skagit Project management should conduct an additional inventory count prior to mid-2004, and future counts on at least an annual basis. Skagit Project management should report all incidents of non-compliance with inventory policies to Seattle City Light top management.

Finding 5: The Current Skagit Project Commute Trip Reduction Program Is Not Cost Effective, and the City Subsidy and Monthly Commute Trip Fees Are High.

Skagit Transit provides transportation services throughout Skagit County, including services for Skagit Project commuters. During 1998, Seattle City Light paid Skagit Transit $750 per month to provide transit service to a monthly average of 43 Skagit Project employees, and supplemented the transit services with a City-owned van.

As shown in Exhibit 5 below, Seattle City Light subsidized the standard the City commute trip reduction program credit, authorized by City Ordinance 116680, to provide transit services to its Skagit-based employees. City commute trip reduction credits covered $7,785 (24 percent) and Seattle City Light paid $13,878 (44 percent) of the total transit expenses, resulting in a total City subsidy of approximately $42 per month for each participating Skagit Project employee.[6] Seattle City Light management was concerned about the additional subsidy, because the total subsidy was 278 percent higher than the $15 per-month transit benefit authorized for City employees.

	1998	2002	Total Increase	Percentage Change
Exhibit 5 **Skagit Project 1998 and 2002 Financial Summary for the** **Commute Trip Reduction Program**				
Expenditures				
Skagit Transit Contract Payment	$9,000	$23,125	$14,125	157%
Seattle City Light Fuel Payment	0	224	224	−100%
Seattle City Light Van Expenses	22,794	13,000	(9,794)	−43%
Total Expenditures	*$31,794*	*$36,349*	*$4,555*	*14%*
Revenue from Employee Contributions				
Employee Payroll Deductions	$ 9,761	$8,748	($1,013)	−10%
Employee Cash Payments	370	0	(370)	−100%
Total Revenue	*$10,131*	*$8,748*	*($1,383)*	*−14%*
City and Skagit Project Subsidies				
Commute Trip Reduction Credit ($15 per employee/month)	$7,785	$5,724	($2,061)	−26%
Additional Skagit Project Subsidy	13,878	21,871	7,993	58%
Total Subsidy	*$21,663*	*$27,595*	*$5,932*	*27%*
Source: Seattle City Light, 2003.				

Commute Trip Reduction Program 1999 Audit Recommendation #1: Seattle City Light should discontinue the vanpool service provided to Skagit Project commuters.

Skagit Project management discontinued operating its own commuter vans in November 2002. At that time, Skagit Transit assumed responsibility for providing daily vanpool services to Skagit Project employees on a contract basis. Skagit Project management continued to furnish fuel for one Skagit Transit van that operated seven days a week.

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[6]The "total" subsidy referenced in this report includes the $15 per-person City of Seattle commute trip reduction benefit.

Despite Seattle City Light's concerns regarding commute trip reduction program expenses in 1998, program costs rose from $31,794 in 1998 to $36,349 in 2002. Skagit Project management increased its subsidy by $7,993 (58 percent) from 1998 to 2002, due to declining ridership, individual commuter contributions, and commute trip reduction program credits. Based on the average monthly ridership of 32 Skagit Project commuters in 2002, the combined annual City and Skagit Project commuting subsidy of $27,595 represented a monthly subsidy of $72 for each employee. By March 2003, Skagit Project management also placed a City-owned van back into service to accommodate commuters' summer work schedules, increasing its commuter program expenses by another $714 per month. This resulted in an increase in the monthly subsidy of $77 for each employee.

Commute Trip Reduction 1999 Audit Recommendation #2*: Seattle City Light should increase Skagit Project employees' monthly share of transit expenses, and establish a monthly fare that is comparable to the fares other commuters pay for public transportation in Western Washington.*

Under the current price structure for the Skagit Project commute trip reduction program, commuters pay an average of $36 per month for vanpool services compared to an average of $17 per month in 1998. This represents a 112 percent increase from 1998 to 2003 for Skagit Project commuters. Exhibit 6 below displays transit fares for Western Washington commuters.[7]

Exhibit 6: Commuter Fares for 1998 and 2003
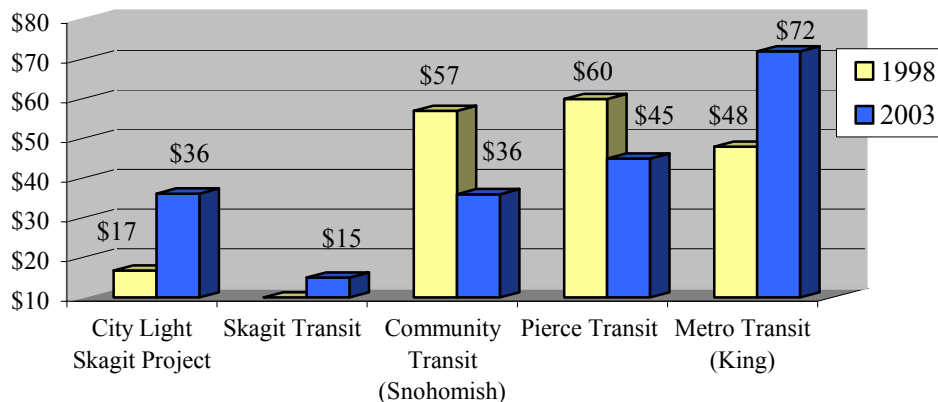
As shown above in Exhibit 6, the Skagit Project employees' transit fares were significantly higher than the $15 fare charged by Skagit Transit to its other bus commuters, but comparable to the fares charged to Community Transit (Snohomish County) and Pierce Transit commuters ($36 and $45 per month, respectively). Skagit Project employees' transit fares were significantly lower than the fares charged by Metro Transit to other King County-based Seattle City Light commuters ($72 per month).[8]

As commute fares rose to $36, Skagit Project's transit ridership fell from 43 commuters in 1998 to 32 commuters in 2002. The combined City and Skagit Project subsidy increased to $72 in

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[7]Data for 1998 Skagit County transit fares was unavailable.
[8]The $72 rate for Metro Transit is based on a monthly, two-zone, peak fare bus pass.

2002 and $77 in 2003, or 513 percent of the City's authorized monthly subsidy. Although the 2003 average subsidy was significantly higher than the average $42 subsidy in 1998, the Director of Generation Plant Operations supported the higher subsidy for Skagit Project employees based on past practices. Again, the authorized commute trip reduction program subsidy is only $15 per month for other City employees.

Skagit Project management is currently negotiating the exchange of one 8-passenger van for a 15-passenger van with Skagit Transit. Under a new agreement, Skagit Project management would discontinue using a City-owned utility van, recalculate the fares, and reduce its commuter subsidy. The combined City and Skagit Project subsidy would decrease to approximately $54 per employee each month, which is still 360 percent of the standard City employee subsidy. Seattle City Light management may also want to consider alternate transit options to further reduce its subsidy for Skagit Project commuters, such as providing the standard $15 commuter benefit directly to employees who establish carpools.

FOLLOW-UP RECOMMENDATIONS

1. Skagit Project management should discontinue operating the City-owned van, and negotiate a reasonable contract price for its Skagit Project employees.

2. Skagit Project management should also pursue other cost-effective alternatives to provide transit services to its employees, such as the authority to pay the standard $15 commuter benefit directly to employees who establish carpools, to decrease its commute trip reduction costs and the amount of the subsidy.

APPENDIX 1
SUMMARY OF SKAGIT PROJECT IMPLEMENTATION
OF 1999 AND 2001 AUDIT RECOMMENDATIONS

Implemented	Partially Implemented	Not Implemented

Recommendations	Implemented			Comments
	Yes	**Partially**	**No**	
COOKHOUSE				
Establish a new Food Service Aide classification with compensation at a rate comparable to prevailing local restaurant wages		▨		Skagit Project management reduced cookhouse labor costs by $257,900 (72 percent) from 1998 to 2002, and could achieve additional savings by creating a food service worker classification with wages comparable to local area restaurant wages.
Continue to seek and implement cost reduction initiatives for more efficient and economical operations of the cookhouse.	▨			Skagit Project management reduced cookhouse costs by $358,263 (71 percent) by minimizing staff hours and food waste, eliminating free meals for contractors, and discontinuing food service outside standard business hours.
Implement accounting systems to ensure that food production and supply costs are charged to appropriate cost centers.	▨			The Food Service Supervisor now uses distinct codes created by the Cost Accounting Section to charge off food production costs for the general store and tour meals.
Negotiate a higher meal price with the tour center and a profit-sharing agreement with the general store.	▨			The tour meal was replaced by a $10 box lunch, and the cookhouse now receives full reimbursement for labor and materials expenses for general store and tour meal products.
Establish a target for reducing the cost per-meal average to a level more consistent with the industry reimbursement rates.			▨	Skagit Project management did not establish an average meal cost target, and the 2002 meal cost of $28.08 continues to exceed the average $14.33 Washington State reimbursement rate.
Establish alternative food service options, such as reimbursement of locally purchased meals, if meal costs cannot be reduced.			▨	Average meal costs decreased from $33.77 in 1998 to $28.08 in 2002. Skagit Project management indicated that they have not explored alternative food service arrangements.
Improve the automated reservation and billing system to generate useful information for accounting and reporting purposes.		▨		The reservation and billing systems produce accurate reports that could be more useful if they interfaced with the Summit system.
Develop reporting formats for routine monitoring of the cookhouse financial data.			▨	Skagit Project management and cookhouse personnel have not developed reporting formats or received Summit training for routine account verification and cost control.

	Implemented	Partially Implemented	Not Implemented

Recommendations	Implemented			Comments
	Yes	Partially	No	
GENERAL STORE				
Operate with a commitment to strong internal control systems for cash handling.		▨		Skagit Project management improved cash-handling controls by limiting access to the safe and discontinuing the practice of leaving registers unlocked or sharing registers among cashiers. Ongoing control weaknesses include: ▪ Employees cashing their own checks; ▪ Infrequent deposits of cash into the bank; ▪ Delayed check deposits into the safe; and ▪ Inconsistent receipting by clerks.
Operate with a commitment to strong internal control systems for inventory handling.			▨	Skagit Project management conducted a physical inventory count resulting in 4,936 (55 percent) adjustments of 9,045 stock items.
Operate with a commitment to strong internal control systems for physical security.	▨			Skagit Project management modified the store layout and installed video cameras.
Implement improved management reporting formats.		▨		Skagit Project management installed the WinSell retail management system to create sales and accounting reports, but also needs higher-level financial and operations reports.
Budget appropriately.		▨		Skagit Project management reduced labor costs by $53,403 (28 percent) between 1998 and 2002, and cut back store winter hours. The general store continues to operate at a deficit.
Study the potential savings of contracting with an experienced vendor to operate the general store.		▨		Skagit Project management retained a consultant to explore contracting out the general store operations, but Seattle City Light chose not to implement the recommendations.
COMMUTE TRIP REDUCTION PROGRAM				
Discontinue the van service provided by Seattle City Light to Skagit Project commuters.		▨		Skagit Project management discontinued but later resumed the van service at a monthly cost of $714.
Establish the employee monthly transit cost at a rate comparable to that of other commuters using public transportation in Western Washington.		▨		In 2002, Skagit Project employees paid fares more comparable to other commuters in Western Washington. However, the combined City and Skagit Project subsidy of $72 per employee was 480 percent more than the $15 subsidy authorized by City Ordinance 116680.

APPENDIX 2
SUMMARY OF EMPLOYEE INVOLVEMENT
COMMITTEE PRELIMINARY REPORT RECOMMENDATIONS

With the goal of achieving a break-even operation of the general store and the cookhouse, the City's Labor/Management Committee chartered an Employee Involvement Committee to make additional recommendations for achieving greater effectiveness and efficiency. The Employee Involvement Committee was comprised of employees who evaluated audit review findings and recent operational improvements, and considered the intrinsic benefits that the general store and the cookhouse provide to employees and the general public. The Committee released its *Preliminary Report: An Investigation of Whether the Skagit General Store and the Diablo Cookhouse Can Be "Break-Even" Operations* in 2001 recommending the following changes:

1. The Seattle City Light Cost Accounting Section should provide monthly operating statements to general store and cookhouse management for frequent feedback on financial performance.
2. Seattle City Light Information Technology should evaluate the efficacy and usefulness of current data management/computer systems at the general store and the cookhouse. Specifically, a review should be completed on the "user-friendliness" of WinSell at the general store and the reservation system at the cookhouse.
3. Skagit Project management should immediately fill the vacancy for a Storekeeper.
4. Accounts Payable should work with the general store to adjust credit card purchasing systems to allow for a broader variety of vendors.
5. The Food Service Supervisor's duties should be expanded to include some food preparation, reducing the need for employing a cook during slower shifts.
6. Seattle City Light should rewrite job specifications for cookhouse summer help and Camp Service Aides and adjust the wage rate to be more consistent with prevailing industry levels.
7. Skagit Project management should task their marketing consultant with studying food service alternatives for employees who rely on the cookhouse (for example, employees or consultants temporarily assigned to the Skagit Project area).

APPENDIX 3
CHANDLER, BROOKS, AND DONAHUE *UPPER SKAGIT TOURS/VISITOR*
ATTRACTIONS OPERATIONS AND MARKETING RECOMMENDATIONS

Due to concerns that visitor-oriented amenities were subsidized by utility revenues, Seattle City Light retained the consulting firm of Chandler, Brooks, and Donahue to develop a strategic plan for these facilities that would comply with federal licensing requirements, eliminate ongoing subsidies within three years, and allow for expansion needed to become self-sustaining.
In April 2001, Chandler, Brooks, and Donahue released the *Upper Skagit Tours/Visitor Attractions Operations and Marketing Recommendations.* The study included the following strategic recommendations that would be implemented within the report-specified time frames:

1. All marketing and management staffing of these facilities (outside of landlord services) should be transferred to the Communications Unit.
2. Skagit Project management should eliminate the meal service for all remaining 2001 tours. (Providing a meal will be an important part of the tour in the future.)
3. The income-generating facilities, including the tours, food services (cookhouse), and general store should be leased to private and/or not-for-profit organizations.
4. The Communications Unit, with the Generation Unit, should create a planning committee to develop a business plan and recruit private operators for the tours, general store, and cookhouse.
5. The Generation Unit should transition the facilities to private/not-for-profit organizations, which will lead to annual savings of more than $850,000 in operational costs and subsidies.
6. The Communications Unit should provide on-site staff to operate the visitor center in Newhalem, and add a Seattle-based staff person to coordinate and manage the concession agreement, implement the business plan, and act as a liaison with concessionaires.
7. All assets should remain under City of Seattle ownership and be leased to concessionaires with annual contract reviews.
8. Seattle City Light should reinvest savings into increased education, outreach and marketing efforts, which will net approximately $500,000 in annual savings to the City.
9. Skagit Project management should attempt to privatize these "opportunities" immediately, so that concessionaire agreements can be negotiated, budgets implemented, and a cooperative marketing effort put into place prior to spring 2002 and the heavy visitor season.
10. The concession agreements should include priority for expanded seasons, additional tour schedules, a stronger marketing effort, and strict guidelines and requirements for tour and educational content.
11. Seattle City Light ratepayers should receive discounts on tours and the use of facilities.
12. Seattle City Light should make immediate efforts to achieve the above recommendations by having them adopted by the City Council; developing a City Light Planning Committee; hiring a Skagit Facilities Coordinator to oversee the privatization and coordination of the visitor-oriented facilities and attractions; and immediately issuing a request for proposal for consulting services to recruit private and not-for-profit organizations for planning, operating and managing these Skagit facilities.

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